SECTION 9000 TARGETED TAX AREA SALE OR USE TAX CREDIT

References 17053.33; 23633

For each taxable year beginning on or after January 1, 1998, a qualified taxpayer engaged in a trade or business within a designated Targeted Tax Area (TTA) can take a credit for sales or use tax paid or incurred in connection with the purchase of qualified property.

The TTA sales or use tax credit applies to qualified property purchased after the designation date of the TTA.

- In any year, individuals may claim a credit equal to the sales or use tax paid or incurred on the purchase of the first $1 million of qualified property.
- In any year, corporations may claim a credit equal to the sales or use tax paid or incurred on the purchase of the first $20 million of qualified property. (See special rule for S corporations and shareholders in EDAM 8540).

No credit may be claimed for property purchased after the TTA designation expires, is revoked, is no longer binding, or becomes inoperative.

9100 Geographic Boundaries and Designation Date

For a listing of TTA cities, see "*TTA Locations and Designation Date*" EDAM 1340. To verify an address, refer to EDAM 1300.

9200 Exclusive Credit

References 17053.33(c); 23633(c)

If the TTA sales or use tax credit is claimed for the purchase of qualified property during the taxable year, no other credit is allowed with respect to that property.

9300 Qualified Taxpayer

References 17053.33(b)(2)(A); 23633(b)(2)(A)

EDAM 9310 Pass-Through Entities

A qualified taxpayer is a person or entity that is engaged in a trade or business within a TTA and whose trade or business is described in the following Standard Industrial Classification (SIC) Manual (1987 edition) code sections:

- Codes 2000 through 2099
- Codes 2200 through 3999
- Codes 4200 through 4299
- Codes 4500 through 4599
- Codes 4700 through 5199

9310 Pass-Through Entities

The determination of whether a taxpayer is a *qualified taxpayer* is made at the entity level. The term "pass-through entity" means any partnership or S corporation. The sales or use tax credit is allowed to the pass-through entity and passed through to the partners or shareholders.

9400 Qualified Property

References 17053.33(b)(1)(C); 17053.33(b)(1)(A); 23633(b)(1)(C); 23633(b)(1)(A)

EDAM 9410 Capitalized Requirement
EDAM 9420 Leased Property

Qualified property is used exclusively in the TTA and is defined as:

Machinery and machinery parts used for:
- Fabricating, processing, assembling, and manufacturing.
- The production of renewable energy resources.
- Air or water pollution control mechanisms.

Generally, qualified machinery parts include those parts that are necessary for the operation of the machinery (e.g., a conveyor belt).

Excluded parts are those used to complete a certain job. They are typically expensed to cost of good sold or general expense accounts. (e.g., specialized drill blades and oil utilized for routine maintenance work).

Effective for taxable years beginning on or after January 1, 1998, the definition of qualified property also includes:

- Data processing and communications equipment, such as computers, computer-automated drafting systems, copy machines, telephone systems, and fax machines; or
- Motion picture manufacturing equipment central to production and post-production, such as cameras, audio recorders, and digital image and sound processing equipment.

9410 Capitalized Requirement

References 17053.33(b)(1); 17053.33(f); 23633(b)(1); 23633(f)

Qualified property must be purchased and placed in service before the TTA expires, is no longer binding or becomes inoperative. Qualified property cost(s) are costs chargeable to a capital account (subject to depreciation) of the qualified taxpayer. If costs are expensed, rather than capitalized, no credit is allowed.

9420 Leased Property

Taxpayers who acquire property by lease arrangement may qualify for the sales or use tax credit. Lease arrangements structured using a financial (conditional sales) contract generally will qualify the taxpayer to take the sales or use tax credit. For reference sources to determine if a lease qualifies as a purchase rather than a lease arrangement, refer to IRS Revenue Ruling 55-540, 1955-2 C.B. 39, and FTB Legal Ruling 94-2, March 23, 1994.

9500 Credit Computation – Asset Value Limitation

References 17053.33(a); 17053.33(b)(1)(B); 23633(a); 23633(b)(1)(B)

EDAM 9510	Use Tax Paid on Qualified Property
EDAM 9520	Depreciable Basis
EDAM 9530	Business Income Activity Limitation
EDAM 9540	General Provisions – Apportionment of Business Income
EDAM 9541	Property Factor – Income Apportionment
EDAM 9542	Payroll Factor – Income Apportionment
EDAM 9543	Apportionment – Combined Groups
EDAM 9544	Apportioning for Personal Income Tax Taxpayers

The sales or use tax credit is equal to the amount of sales or use tax “paid or incurred” by the taxpayer in connection with the purchase and use of qualified property.

Example: Taxpayer spent $53,750 to purchase machinery used in the taxpayer's business within the TTA. The sales tax paid on the purchase is $3,750. The sales tax credit is $3,750.

Individuals, estates or trusts, partnerships, and limited liability companies (LLCs) taxed as partnerships may claim a credit on the sales or use tax paid or incurred to purchase up to $1 million of qualified property. Corporations may claim a credit on the sales or use tax paid or incurred to purchase up to $20 million of qualified property. This limitation applies to each taxable year. (See special rule for S corporations and shareholders in EDAM 8540).

NOTE: Upon acquisition, if the taxpayer/purchaser was exempt from paying sales tax on the property under the California Revenue & Taxation Code (CR&TC), then the taxpayer/purchaser did not pay or incur sales tax in connection with the purchase of the property to the extent of the exemption. Thus, the taxpayer/purchaser is not allowed to take the sales or use tax credit on the amount of the exemption.

9510 Use Tax Paid on Qualified Property

References 17053.33(d); 23633(d)

If a taxpayer, operating within a TTA, purchases property out of state and pays or incurs a use tax, the credit is allowed only if qualified property of a comparable quality and price is not timely available for purchase in this state.

9520 Depreciable Basis

References 17053.33(f); 23633(f)

Any taxpayer that elects to claim the sales or use tax credit, shall *not* increase the basis of the qualified property by the amount of the sales or use tax paid or incurred.

Example: Taxpayer spent $53,750 to purchase machinery used in the taxpayer's business within the TTA. The sales tax included in the purchase price was $3,750. The basis of the property is $50,000 ($53,750 less $3,750 sales tax).

9530 Business Income Activity Limitation

References 17053.33(g)(1); 23633(g)(1)

The amount of sales or use tax credit or hiring credit (see EDAM 9700) claimed, including any credit carryover from prior years, may not exceed the amount of tax on the TTA business income in any year. The TTA business income is that portion of the taxpayer's *California source* business income that is apportioned to the TTA. Non-business income or loss is not included in the calculation of business income from the TTA.

Example: Corp. A operates exclusively within the TTA. In order to determine the amount of sales or use tax credit allowable, the business income and the tax on that business income must be determined. Corp. A has the following items of income and expense:

Income from business operations	$30,000
Interest from investment which is unrelated to Corp. A's business operations	$2,000
Business expenses	(17,000)
Net Taxable Income	$15,000

Corp. A's income attributed to business operations is:

Income from business operations	$30,000
Business expenses	(17,000)
Net Business Income	$13,000

To determine the sales or use tax credit allowable, the net business income is multiplied by the current tax rate.

Net Business Income	$13,000
x 8.84%	x .0884
Tax associated with business income	$1,149

In this example, the taxpayer can offset the tax of $1,149 with the sales or use tax credit available (up to $1,149).

NOTE: "net tax"/"tax" and alternative minimum tax impose limitations on the allowable offset but were not considered a factor in this example.

9540 General Provisions – Apportionment of Business Income

References 17053.33(g)(1); 17053.33(g)(3)(B); 23633(g)(1); 23633(g)(3)(B)

If a business is located within and outside of a TTA, the taxpayer must determine the portion of the total business income that is attributable to each TTA.

- Business income is defined under the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA).
- Components of the factors are defined under the provisions of UDITPA.

For taxable years beginning on or after January 1, 1998, business income is apportioned to the TTA by multiplying the taxpayer's *California* source business income by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two (2).

9541 Property Factor – Income Apportionment

The property factor is a fraction. The numerator of the property factor is the average value of the real and tangible personal property owned or rented and used or available for use by the taxpayer *within the TTA* during the taxable year. The denominator is the average value of all real and tangible personal property owned or rented and used or available for use by the taxpayer during the taxable year *within California*.

Rented property is valued at 8 times the net annual rental rate. The net annual rental rate is the total rent paid for the property, less any subrental rates paid by subtenants.

9542 Payroll Factor – Income Apportionment

The payroll factor is a fraction. The numerator of the payroll factor is the total compensation paid to employees working for the taxpayer *within the TTA* during the taxable year. The denominator is the total compensation paid to employees working for the taxpayer *within California* during the taxable year.

Example: Corp. A operates within and outside a TTA. California business income of $13,000 needs to be apportioned to the TTA. The following amounts apply to Corp. A's property and payroll:

TTA Property	$40,000
CA Property	$100,000
TTA Payroll	$5,000
CA Payroll	$10,000

TTA Property/CA Property	=. 40	
TTA Payroll/CA Payroll	=. 50	
	.90/2 = .45	TTA Apportionment Factor

Business income	$13,000
Apportionment Factor	x 0.45
TTA Business Income	$5,850
Current Tax Rate	x .0884
Tax attributable to TTA business income	$517

9543 Apportionment – Combined Groups

For members of a combined group, the limitation will be based on the intrastate apportioned business income for each taxpayer doing business within the TTA. The numerator of the apportionment formula will be based on each TTA taxpayer's separate TTA property and payroll amounts and the denominator will be based on each TTA taxpayer's separate California property and payroll amounts.

Example: For the taxable year ended 12/31/2001, Parent Corporation A has two subsidiaries, B and C. Corporations A and B operate within the TTA. The combined group operates within and outside California and apportions its income to California using Schedule R. The combined group's business income apportioned to California was $1,000,000. Corporation A and B's share of California business income is $228,000 and $250,000 respectively. Corporation A and B's separate TTA and separate California property and payroll factor amounts are shown below.

Business income apportioned to the TTA was determined as follows:

	A	B
Property Factor		
TTA Property	$1,000,000	$ 800,000
California Property	$1,000,000	$1,200,000
Apportionment %	100%	66.66%
Payroll Factor		
TTA Payroll	$800,000	$ 800,000
California Payroll	$800,000	$1,000,000
Apportionment %	100%	80%
Average Apport. %	100%	73.33%
(Property + Payroll Factors)/2		
Apportioned		
Business Income	$228,000	$250,000
TTA Income	$228,000	$183,333

9544 Apportioning for Personal Income Tax Taxpayers

The following examples show the application of the apportioning rules to personal income tax taxpayers.

Example: Ray Smith is vice president of an S corporation that has two locations, one within a TTA and one outside the TTA. Eighty percent (80%) of the S corporation's business is attributable to the TTA. (**NOTE**: This percentage was determined by the S corporation, using Worksheet IV from the FTB 3809 Business Booklet, at the time the S corporation return was prepared). Ray divides his time equally (50% & 50%) between the two offices of the S corporation.

Mary Smith (Ray's spouse) works for the S corporation at its office located in the TTA.

Ray and Mary Smith have the following 1999 items of California income and expense:

Ray's salary from the S corp.	$100,000
Mary's salary from the S corp.	75,000
Interest on savings account	1,000
Dividends	3,000
Schedule K-1(100S) from the S corp.	
Ordinary income	40,000
TTA business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

*The TTA business expense deduction is a separately stated item on Schedule K-1 (100S).

The Smith's TTA income is computed as follows:

Ray's TTA salary ($100,000 x 50%)	$50,000
Mary's TTA salary ($75,000 x 100%)	75,000
Pass-through ordinary income from the S-Corp. ($40,000 x 80%)	32,000
TTA business expense deduction from the S-Corp.	(5,000)
Ray's unreimbursed employee business expenses (2,000 x 50%)	(1,000)
Total TTA income	$151,000

Ray and Mary must compute the tax on the total TTA income of $151,000 (as if it represents all of their income). Using the tax rate schedule for the filing status *married filing joint*; the 1999 tax on

$151,000 is $10,659. The $10,659 is the first limitation on TTA credits for the 1999 taxable year. The second limitation on the credits is the *net tax* on all income.

NOTE: The standard deduction and personal or dependency exemptions are not included in the computation of TTA income since they are not related to trade or business activities.

9600 S Corporation & Shareholder Credit Amounts

References 17053.33(b)(1)(B); 17053.33(b)(2)(B); 23633(b)(1)(B); 23633(b)(2)(B); 23803

S corporations operating within a TTA may claim a credit on the sales or use tax paid or incurred to purchase up to $20 million of qualified property. This limitation applies to each taxable year. The S corporation may only use one-third (1/3) of the credit to reduce the tax on the S corporation's TTA income.

An S corporation's sales or use tax credit may reduce the TTA tax at both the corporate and shareholder levels. One hundred percent (100%) of the TTA credits are passed through to the S corporation shareholders. However, S corporation shareholders are only allowed to claim a credit on the sales or use tax paid or incurred on the purchase of up to $1 million of qualified property of the S corporation for each taxable year. The shareholders claim their pro-rata share of this credit as recomputed under the California personal income tax law (Part 10).

The sales or use tax credit is first computed for the S corporation using the actual qualified acquisition costs not to exceed $20 million. The amount of credit passing through to the shareholders is then computed using the actual qualified acquisition costs not to exceed $1 million. This credit based on the $1 million limitation is passed through to the shareholders based on their pro rata share. The Schedules K (100S) and K-1 (100S) must state the credit amounts allocable to the shareholders.

Example: Corp. Z, an S corporation, purchases $2 million of qualified property, and takes the TTA sales or use tax credit. Corp. Z is allowed to claim a sales or use tax credit of $50,000 ($2,000,000 x 7.5% x 1/3 = $50,000). [Cost (not to exceed $20,000,000) x sales tax rate x 1/3 S corporation credit limitation]

The corporation's two shareholders allocate between them a sales or use tax credit of $75,000 ($1,000,000 x 7.5% = $75,000). [Cost (not to exceed $1,000,000) x sales tax rate]

NOTE: The State Board of Equalization in an unpublished (non-citable) decision, concluded that the $20 million limitation applied to the S-Corp and the $1 million limitation applied collectively to the S-Corp shareholders. *Appeal of Barry and Wendy Breslow,* Cal. St. Bd. Of Equal., November 6, 2001.

9700 Sales Or Use Tax Credit And The Hiring Credit

References 17053.33(g)(1); 23633(g)(1)

The amount of credit(s) allowed, in any taxable year, when a taxpayer is eligible to take both the sales or use tax credit and the hiring credit, is limited to the amount of tax imposed on the TTA business income. Thus, the taxpayer must aggregate the credits and limit the total amount of credits to tax imposed on the TTA business income.

9800 Credit Usage and Carryover

References 17053.33(e), 17053.33(g)(1); 23633(e); 23633(g)(1)

EDAM 9810	Credit Will Not Reduce Certain Taxes
EDAM 9820	Depreciation
EDAM 9830	Credit Recapture

The portion of the credit that exceeds the "net tax"/"tax" for the taxable year, is carried over and added to the credit, if any, in the following year. The credit is carried over to succeeding years, until it is exhausted.

The aggregate amount of the TTA credits, including any credit carryover from prior years, that may reduce the "net tax"/"tax" for the taxable year, shall not exceed the amount of tax imposed on the taxpayer's business income attributable to the TTA, determined as if that income represented all of the income of the taxpayer.

Example: A taxpayer has $4,900 in TTA credits (sales or use tax credit *and* hiring credit). Tax imposed on TTA business income is $4,700 and the taxpayer's overall "net tax"/"tax" is $4,000. The maximum amount of credit is limited to the lesser of the tax on the TTA business income, or the tax on the taxpayer's overall "net tax"/"tax".

Total TTA credit	$4,900
Tax on TTA income	$4,700
First limitation:	
Lesser of total credit or tax on TTA income	$4,700
Second limitation:	
Lesser of tax on TTA income or "*net tax*"/"*tax*"	$4,000
Maximum credit allowed:	
Lesser of *TTA tax limitation* or "*net tax*"/"*tax*" *limitation*	$4,000
Total TTA credit	$4,900
Maximum credit allowed	$4,000
Carryover	$ 900

In the event that a credit carryover is allowable for any taxable year after the TTA designation expires, is revoked, is no longer binding, or becomes inoperative, the TTA is deemed to remain in existence for the purpose of computing the business income limitation.

9810 Credit Will Not Reduce Certain Taxes

The TTA sales or use tax credit cannot reduce the:

- Minimum franchise tax (corporations, limited partnerships, limited liability partnerships, LLCs, and S corporations);
- Annual tax (partnerships, LLCs classified as partnerships, and Qsubs);
- Built-in gains tax (S corporations);
- Excess net passive income tax (S corporation); or
- Alternative minimum tax (corporations, exempt organizations, individuals and fiduciaries).

The TTA sales or use tax credit may however reduce regular tax below tentative minimum tax.

9820 Depreciation

References 17053.33(f); 23633(f); 18036; 17267.6(f); 24356.6(e); 24916

Taxpayers electing to utilize the sales or use tax credit are not entitled to increase the basis of the property for which sales or use tax was paid or incurred in connection with the purchase of the property.

Depreciation of the capitalized cost of the asset may be claimed using any method of depreciation allowable beginning in the year the asset is placed in service.

NOTE: If the business expense deduction is taken for the same property, depreciation will start with the taxable year following the year in which the property is placed in service. The depreciation is calculated on the remaining basis *after* reduction for the sales or use tax credit and business expense deduction amounts.

9830 Credit Recapture

There are no recapture provisions for the TTA sales or use tax credit.

9900 Record Keeping Requirements

To support the sales or use tax credit claimed, the taxpayer must keep all records that document the purchase of the qualified property and payment of sales or use tax. This includes items such as purchase receipts and proof of payment. In addition, taxpayers should keep all records that identify or describe:

- The property purchased (such as serial numbers, etc.);
- The amount of sales or use tax paid or incurred upon purchase;
- The location where the property is used;
- Sales or Use Tax Returns filed with the Board of Equalization;
- Audit reports issued by the Board of Equalization for audits related to use tax paid, or fixed asset audits; and
- If purchased from a manufacturer located outside California, records to substantiate that property of comparable quality and price was not available for purchase in California.